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Blog Post

Tipped and Non-Tipped Work Back Under the Microscope

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The old "80/20 rule" is back again for tipped workers under the latest proposed Final Rule issued by the Department of Labor (DOL) last month. Employers in the service industry, especially those employers who take a tip credit and/or implement a tip pool for their employees, should keep an eye on this latest Final Rule. Under the Trump Administration, the DOL had issued a different Final Rule in its final weeks which was intended to formally incorporate a 2018 tip credit amendment to Section 3(m)(2) of the Fair Labor Standards Act (FLSA) into the DOL's tip regulations and guidance. That version of the Final Rule was set to go into effect on March 1, 2021, until the Biden Administration asked the DOL to postpone its implementation pending review. The DOL's Notice of Proposed Rulemaking, issued on June 23, 2021, proposes to withdraw and amend the portion of the Trump Administration version of the Final Rule concerning when an employer can take a tip credit for an employee performing tipped and non-tipped work/dual jobs. Comments on the proposed Final Rule are due by August 23, 2021 and can be submitted here.

The new proposed Final Rule, along with the proposed changes outlined in the Notice of Proposed Rulemaking, would remove DOL regulations that prohibited certain employers from including employees who do not customarily and regularly receive tips from mandatory tip pooling

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arrangements and would codify the 80/20 rule referenced in some DOL opinion letters. Under the proposed Final Rule, employers would need to track the time spent by tipped workers on work that "directly supports" tip-producing work, and on work that does not. Employers would have to pay at least the full minimum wage for time in excess of 20 percent of an employee's work hours or continuous periods exceeding 30 minutes on work that does not directly support tip-producing work. More details are below.

What is New Under the Proposed Final Rule?

First, the proposed Final Rule adopts the Section 3(m)(2)(B) of the FLSA which prohibits an employer from keeping tips received by its employees "for any purpose," regardless of whether the employer takes a tip credit. However, an employer can control tips only for the purpose of (1) promptly distributing tips to the employee or employees who received them; (2) requiring employees to share tips; or (3) to facilitate tip pooling by collecting and promptly redistributing employees' tips to employees in a tip pool. Employers are also authorized to deduct the actual cost of credit card processing charges from employees' tips.

Second, the proposed Final Rule also adopts the Section 3(m)(2)(B) of the FLSA which prohibits managers or supervisors from obtaining employees' tips directly or indirectly from a tip pool. The proposed Final Rule outlines that employers should apply the duties test and not the salary test under the FLSA's executive employee exemption when determining which employees qualify as managers or supervisors who may not keep tips under Section 3(m)(2)(B).

Third, the proposed Final Rule revises the DOL's regulations to allow employers that do not take a tip credit to implement nontraditional tip pools, so long as those tip pools do not include employers, managers, or supervisors and so long as the

employer does not take a tip credit and pays the full minimum wage to both the tipped employees who contribute to the pool and the nontipped employees who receive tips from the pool. Section 3(m)(2)(A) expressly prohibits employers that take a tip credit from including employees that do not customarily and regularly receive tips in mandatory tip pools together with employees that do. Employers who do not take a tip credit from their employees do not face this restriction.

Fourth, the proposed Final Rule also provides new recordkeeping requirements for employers that have employees who receive tips. These recordkeeping requirements also apply for employers who do not take a tip credit but still collect employees' tips to operate a mandatory tip pool. Employers will be required to identify each employee for whom they take a tip credit and who receive tips, and must maintain records regarding the weekly or monthly amount of tips reported by an employee. Employers may use IRS Form 4070 to satisfy this recordkeeping requirement.

Fifth, as indicated above, should the new proposed Final Rule go into effect, employers would only be allowed to take a tip credit when its tipped employees perform work that produces tips, or perform work that directly supports the tip-producing work, provided that the directly supporting work is not performed for a substantial amount of time. Under the proposal, work that "directly supports" tip-producing work is work that assists a tipped employee in performing the work for which the employee receives tips. The proposed regulation lists tasks in three common tipped occupations—servers, bartenders, and nail technicians—that would fall within the categories of tipped occupation, and it also provides tasks that exemplify work that "directly supports" tip-producing work. For example, a server's tip-producing work includes waiting on tables, and work that directly supports the server's tip-producing work includes cleaning tables, folding

napkins, preparing silverware before serving food to customers. A nail technician's tip-producing work entails manicures and pedicures, and work that directly supports the nail technician's tip-producing work includes cleaning the pedicure baths between customers.

The proposal also provides some insight for determining when an employee has performed direct support work for a "substantial amount of time" to not allow an employer to take a tip credit. The proposal explains that a substantial amount of time is work that either (1) exceeds, in the aggregate, 20 percent of the employee's hours worked during the workweek or (2) is performed for a continuous period of time exceeding 30 minutes. The proposal explains that if a tipped employee spends more than 20 percent of their workweek performing directly supporting work or if a tipped employee spends a continuous, or uninterrupted, period of time performing directly supporting work that exceeds 30 minutes, the employer cannot take a tip credit for any time that exceeds 20 percent or for the entire period of time that was spent on such directly supporting work.

Sixth, the proposed Final Rule outlines how the DOL will approach repeated and willful violations of Section 3(m)(2)(B) by an employer. Under Section 3(m)(2)(B), an employer who unlawfully keeps an employee's tips (including when they allow managers or supervisors to keep any portion of employees' tips) may face a civil money penalty of up to $1,100 for each violation, in addition to being liable to the employee(s), and has to pay liquidated damages in an additional equal amount to the employee(s). In determining whether a repeated or willful violation has occurred, the DOL will examine all facts and circumstances surrounding an employer's violation. Under the proposed Final Rule, proof that an employer should have inquired further into whether its conduct was in compliance with the FLSA and failed to do so is an element in assessing an employer's reckless disregard of the FLSA.

Furthermore, employers should be aware that advice from the DOL Wage and Hour Division that their conduct was unlawful under Section 3(m)(2)(B), while not automatically dispositive on the issue of willfulness, can be used against them to show that a violation of the FLSA was willful.

Employers that use the tip credit should continue to monitor developments regarding the DOL's proposed Final Rule and consult their labor and employment counsel with questions on tip credits and tip pooling.
